Fiscal Note

Fiscal Services Division

SF 2206 – Income, Sales, and Tax Credit Modifications (LSB5099SV)
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Fiscal Note Version – New

Description

Senate File 2206 relates to taxation, tax credits, and State and local finance. Provisions of the Bill have various effective dates. **Tables 3 and 4** summarize the fiscal impacts of the various Bill divisions and can be found at the end of this fiscal note.

Divisions I Through IV — Sales/Use Tax Rate Increase and Tax Base Expansion

Description and Background

The Bill increases the sales/use tax rate 1.0 percentage point to 7.0%. One percentage point of the sales/use tax collected will be distributed to local school districts for the program known as Secure an Advanced Vision for Education (SAVE). The Bill eliminates the Local Option Sales Tax (LOST) but specifies that 1.0% of the sales/use tax collected will be deposited into the Local Sales and Use Tax Fund to be distributed to the county from which the tax was collected. The increased sales/use tax rates are effective January 1, 2023, through December 31, 2050.

Increasing the sales tax rate triggers the funding of the Natural Resources and Outdoor Recreation Trust Fund (Trust Fund) so a portion of the revenue generated by the change must be used for the purposes of the Trust Fund.

The Bill makes the following changes to the sales tax base effective January 1, 2023:

- Replaces “software as a service” with “cloud computing” for purposes of imposing the sales tax.
- Makes web hosting and digital automated services subject to the sales tax.
- Exempts cloud computing, web hosting, and digital automated services purchased for use by commercial enterprises from the sales tax.
- Makes scooter rental services subject to the sales tax.
- Eliminates the sales/use tax exemption on the sales price from the sale or rental of computer or computer peripherals by an insurance company, financial institution, or commercial enterprise.
- Removes “professionals and occupations” from the definition of “commercial enterprise” making sales to professions and occupations related to prewritten software, specified digital services, and other services subject to the sales tax.

The Bill allows a taxpayer to have a combined sales and use tax permit and to file a combined sales and use tax return. The Bill directs the Department of Revenue to distribute the LOST based on actual tax remitted rather than estimates.

Assumptions/Fiscal Impact (Divisions I Through IV)

- The Department estimates that sales/use tax revenue will increase 3.6% in FY 2023, 3.0% in FY 2024, 2.7% in FY 2025, 2.6% in FY 2026, 3.0% in FY 2027, and 3.0% in FY 2028.

Those Department estimates are used for calculations of those fiscal years. The tax increase associated with the increased sales/use tax rate along with changes to items added to the base and the removal of exemptions is shown in **Table 1**.

Table 1 — Increase in Sales/Use Tax Collected

In Millions

	Scooter Rentals	Professions and Occupations for Purchase of Digital Goods	Remove Exemption for Computers and Peripherals	Water Sales	Sales/Use Tax Rate Increase to 7.0%	Total Projected Increase to Sales/Use Tax Collected
FY 2023	$ 0.0	$ 1.4	$ 34.6	$ 23.9	$ 315.0	$ 374.9
FY 2024	0.1	3.0	69.9	49.1	650.5	772.5
FY 2025	0.1	3.1	71.6	50.6	668.0	793.5
FY 2026	0.1	3.2	72.2	52.1	685.6	813.2
FY 2027	0.1	3.4	69.7	53.7	705.9	832.8
FY 2028	0.1	3.6	66.2	55.3	727.0	852.1

The FY 2023 amount is for one-half of the fiscal year.
Totals may not add due to rounding.

- The increased collection of sales/use tax due to changes in the base will increase the projected revenue for SAVE. The Department projects increases to SAVE revenue by the following amounts:
  - FY 2023 = $8.3 million (for one-half of the fiscal year)
  - FY 2024 = $16.9 million
  - FY 2025 = $17.3 million
  - FY 2026 = $17.6 million
  - FY 2027 = $17.5 million
  - FY 2028 = $17.3 million
- The net fiscal impact to counties due to the elimination of the LOST and increase in sales/use tax collections transferred to the Local Sales and Use Tax Fund is shown in **Table 2**.

Table 2 — Elimination of LOST and Transfer to the Local Sales and Use Tax Fund

In Millions

	Elimination of LOST	Transfer to the Local Sales and Use Tax Fund	Total Projected Net Transfer Increase to Counties
FY 2023	$ -290.0	$ 313.6	$ 23.6
FY 2024	-597.6	645.9	48.3
FY 2025	-613.4	663.1	49.6
FY 2026	-629.4	680.1	50.8
FY 2027	-659.8	699.2	39.4
FY 2028	-667.1	719.5	52.4

The FY 2023 amount is for one-half of the fiscal year.
Totals may not add due to rounding.

- Article VII, section 10, of the Iowa Constitution specifies an increase in the sales tax rate as the condition necessary to trigger the funding requirements of the Trust Fund. The text of this Constitutional amendment is reprinted at the end of this ***Fiscal Note***. The Constitution requires that an amount equal to the revenue raised by a tax rate of three-eighths of 1.0% is required to be deposited into the Trust Fund. The use tax is not mentioned in the relevant language of the Constitution. The Department calculations for transfers to the Trust Fund do not include consumer's use tax or retailer's use tax. The amounts for transfers to the Trust Fund also do not include State hotel/motel tax, auto rental tax, construction equipment

tax, and tax on specified digital products. Transfers to the Trust Fund are estimated to be the following amounts:

- FY 2023 = $92.9 million (for one-half of the fiscal year)
- FY 2024 = $191.4 million
- FY 2025 = $196.4 million
- FY 2026 = $201.5 million
- FY 2027 = $207.1 million
- FY 2028 = $213.2 million

Division V — Stock Capital Gains Income Tax Exemption

Description and Background

The Bill exempts capital gains earned through the sale or exchange of capital stock in a qualified corporation. The exemption is available to taxpayers defined under the Bill as employee-owners and applies to stock in a qualified company that was acquired while employed by and on account of employment with the qualified company. The Bill grants one irrevocable lifetime election to exclude such capital gains income and the exemption is phased in over three calendar years. The change is effective beginning with calendar year (CY) 2023, and 33.0% of any qualified capital gains will be exempt for that year while 66.0% will be exempt for CY 2024. Beginning with CY 2025, qualified sales will be fully exempt from Iowa individual income tax.

Assumptions/Fiscal Impact (Division V)

The Department based the stock capital gains fiscal impact projection on a similar provision of Nebraska tax law that has been in place for a number of years. The Department extrapolated the Iowa estimate from available estimates of the Nebraska law's impact on that state's tax revenue, with adjustment factors for differences in the proposal, state tax rates, and size of the two states' corporate sectors.

The Department projects that the stock capital gains income tax exemption will reduce tax liability and General Fund revenue by the following amounts:

- FY 2024 = $4.0 million
- FY 2025 = $7.6 million
- FY 2026 = $10.3 million
- FY 2027 = $8.9 million
- FY 2028 = $8.8 million

Fiscal impacts beyond FY 2028 are projected to continue, increasing each year at the rate of inflation. The Department's fiscal impact projection assumes the tax rates and retirement income exemption changes also included in this Bill. This means that if the stock capital gains provisions were estimated separately from the Bill's other provisions, the fiscal impact would be higher.

Division VI — Farm Lease Income Tax Exemption

Description and Background

The Bill exempts total net income received by a retired farmer pursuant to a farm tenancy agreement covering real property if the retired farmer held the property for 10 years or more and materially participated in a farming business for 10 years or more. To be eligible, a retired farmer must be 55 years of age or older and must no longer materially participate in farming. The exemption is effective beginning January 1, 2023.

Assumptions/Fiscal Impact (Division VI)

The Department based the farm lease income tax exemption fiscal impact projection on federal Internal Revenue Service (IRS) data covering taxpayers who filed electronically and met all of the following three criteria:

- Reported net farm rental income.
- Filed IRS schedule F for the past 10 years.
- One or both taxpayers on the return were age 55 or older.

In addition, the Department further adjusted numbers and amounts to account for retired farmers identified who are currently utilizing the Beginning Farmer Tax Credit since the Bill prohibits utilizing both that credit and this new exemption. The Department analysis concluded that 1,295 returns will qualify each year for the new exemption, with combined annual farm lease income of $37.8 million (an average of $29,157 per return).

The Department projects that the farm lease income tax exemption will reduce tax liability and General Fund revenue by the following amounts:

- FY 2024 = $2.1 million
- FY 2025 = $2.0 million
- FY 2026 = $1.8 million
- FY 2027 = $1.5 million
- FY 2028 = $1.5 million

Fiscal impacts beyond FY 2028 are projected to continue, increasing each year at the rate of inflation. The Department's fiscal impact projection assumes the tax rates and retirement income exemption changes also included in this Bill. This means that if the farm lease income tax exemption provisions were estimated separately from the Bill's other provisions, the fiscal impact would be higher.

Division VII — Farm Capital Gains Income Tax Exemption

Description and Background

The Bill expands the farm capital gains income exemption, which is available beginning tax year (TY) 2023 on the sale of real property used in a farming business and the sale of cattle, horses, and breeding livestock. The changes expand the qualifying time frame for retired farmers to have materially participated in farm operations. The exemption is effective beginning January 1, 2023, and applies to sales consummated on or after that date.

Assumptions/Fiscal Impact (Division VII)

The Department utilized the following facts, sources, and assumptions to estimate the fiscal impact of the Division:

- The Bill requires that a taxpayer choose between the lease income exemption contained in Division VI and the capital gains exemption. It is assumed that taxpayers with this choice will choose the ongoing lease income exemption instead of the capital gains exemption.
- The Bill prohibits taxpayers from benefiting from this new tax exemption during a tax year in which they claim the Beginning Farmer Tax Credit. The Department's estimate adjusts for this interaction.
- Current Iowa law allows a farmer to exempt from taxable income certain capital gains from the sale of real property used in a farm business (reported on Form IA 100B). This Bill expands the narrow area of farm capital gains exemptions available under current law. The

Department assumes that an additional 948 retired farmers will benefit from the capital gains exemption each year, with a total exempted annual income amount of $113.1 million.

- Current Iowa law allows a farmer to exempt from taxable income the certain capital gains from the sale of cattle, horses, and breeding livestock (reported on Form IA 100A). This Bill expands the narrow area of capital gains exemptions available under current law. The Department assumes that an additional 230 retired farmers will benefit from the capital gains exemption each year, with a total estimated annual exempted income amount of $25.7 million.

The Department projects that the farm capital gains income tax exemption will reduce tax liability and General Fund revenue by the following amounts:

- FY 2024 = $7.2 million
- FY 2025 = $6.9 million
- FY 2026 = $6.1 million
- FY 2027 = $5.1 million
- FY 2028 = $5.3 million

Fiscal impacts beyond FY 2028 are projected to continue, increasing each year at the rate of inflation. The Department's fiscal impact projection assumes the tax rates and retirement income exemption changes also included in this Bill. This means that if the farm capital gains income tax exemption provisions were estimated separately from the Bill's other provisions, the fiscal impact would be higher.

Divisions VIII, IX, and X — Income Tax Rate Reductions and Retirement Income Tax Exemption

Description and Background

The Bill reduces Iowa individual income tax rates annually for TY 2023 through TY 2025, and establishes a single tax bracket/rate for TY 2026 and after. Under existing law, Iowa's TY 2023 and after top individual income tax rate is 6.50%. The Bill reduces the top tax rate to 6.00% for TY 2023, 5.70% for TY 2024, 4.82% for TY 2025, 3.85% for TY 2026, and 3.60% for TY 2027 and after. The number of brackets and the bracket income levels are also reduced over the years. Corresponding reductions are made in the alternate tax rate that may apply in situations related to a taxpayer's qualification for Iowa's universal and age-based low-income exemptions from the individual income tax (Iowa Code sections 422.5(3) and 422.5(3B).

Division IX also provides for a contingent individual income tax rate reduction process that begins with TY 2029. This process and the fiscal implications are discussed in the following section of this ***Fiscal Note***.

Division VIII (income tax rate reductions through TY 2025) takes effect January 1, 2023. Division IX (single bracket/rate) takes effect January 1, 2026.

Iowa's TY 2022 top individual income tax rate is 8.53%, and that rate applies to taxable income over $78,435. Under provisions enacted in 2018 Iowa Acts, chapter 1161, Iowa's current-law income tax rates and brackets will change starting TY 2023. Under this impending change, Iowa's top tax rate will be 6.50% and will apply to taxable income exceeding $150,000 for married couples filing joint returns and $75,000 for all other filing categories. This Bill strikes the current-law TY 2023 rates and replaces them with lower tax rates and lower tax brackets.

Division X exempts all income defined as retirement income from the State individual income tax for disabled taxpayers and taxpayers aged 55 years or older. The exemption also applies to a deceased person's retirement income that is received by a surviving spouse or a person with

an insurable interest in the deceased person. The change replaces the current exemption which is described in the next paragraph. The change does not alter the full retirement pay exemption available to retired military personnel, which is not based on age or disability. The Bill also excludes retirement income from the calculation of Iowa's universal and age-based low-income full exemptions from individual income tax. The changes are effective beginning TY 2023.

Current Iowa law allows for a retirement income exemption of up to $6,000 for single filers or $12,000 for married filers. This exemption is available to disabled taxpayers and taxpayers age 55 and older. Military retirement income received from the federal government and Social Security income are also fully excluded from Iowa income tax under current law.

Iowa law contains two separate net income thresholds below which low-income taxpayers are not subject to the Iowa income tax. The first threshold applies to all potential taxpayers and is generally equal to $9,000 of net income for single taxpayers and $13,500 for married taxpayers, heads of households, and surviving spouses. This universal low-income threshold generally does not apply to dependents. In determining whether the taxpayer qualifies for the low-income threshold and is therefore fully exempt from Iowa income tax, net income includes sources of income that are not subject to Iowa income tax.

The second threshold is based on higher amounts that apply only to taxpayers who are age 65 or older. The threshold is generally equal to $24,000 of net income for single taxpayers and $32,000 for married taxpayers, heads of households, and surviving spouses. Like the universal low-income threshold, this age-based threshold generally does not apply to dependents. The age-based low-income threshold is available to both spouses as long as one spouse is age 65 or older.

The changes in the Bill to the calculation of the two full-exemption thresholds will allow taxpayers to benefit from the low-income exemptions without regard to the amount of the taxpayers' retirement income.

Assumptions/Fiscal Impact (Divisions VIII, IX and X)

The tax reduction estimate was completed by the Department using the individual income tax micromodel developed by the Department. The micromodel is based on income tax returns filed for TY 2020 and is time-adjusted for previously enacted State and federal law changes, as well as personal income and population changes that are projected to occur after the 2020 base tax year.

The model results are adjusted to account for persons who pay Iowa income tax through income tax withholding or other means but do not file Iowa income tax returns. Since the micromodel is composed of filed income tax returns, it does not account for people who make individual income tax payments but then do not file an Iowa income tax return. While not the only example of payments the State might receive from people who do not file income tax returns, most of the payments likely arrive in the form of income tax withholding. When the State lowers income tax rates and/or withholding tables, these nonfilers also receive an income tax reduction. To account for this and other types of nonfiler income tax payments, the micromodel results are adjusted based on the Department's estimate of the amount of nonfiler income tax revenue the State will receive under current law and under the proposed law.

The micromodel produces tax year basis results. The Department converts tax year results to fiscal year estimates using historical relationships between income tax withholding, estimate payments, tax refunds, and payments with filed tax returns. The individual income tax rate

changes and retirement income exemption are projected to reduce net individual income tax liability and State General Fund revenue by the following amounts:

- FY 2023 — $216.7 million
- FY 2024 — $482.0 million
- FY 2025 — $666.8 million
- FY 2026 — $1,245.9 million
- FY 2027 — $1,807.7 million
- FY 2028 — $1,949.6 million

For years beyond FY 2029, the projected tax liability and State General Fund revenue reductions are expected to increase at the rate of growth in Iowa personal income.

Division IX — Additional Estimate — Future Individual Income Tax Rate Reduction

Description and Background

The Taxpayer Relief Fund (TRF) receives transferred funds at the end of a fiscal year in which actual net General Fund revenue for that fiscal year exceeded the Revenue Estimating Conference adjusted net revenue estimate for that fiscal year. The TRF also receives interest on its balance. Moneys in the TRF may only be used pursuant to appropriations or transfers made by the General Assembly for tax relief. There are no future appropriations or transfers from the TRF currently provided in law.

Along with establishing a single individual income tax rate of 3.85% for TY 2026 and 3.60% for TY 2027 and after, Division IX creates an annual potential individual income tax rate reduction process that starts with TY 2030. Under this new process and beginning after the conclusion of FY 2029, the Department of Management (DOM) and the Department of Revenue (DOR) are directed to annually collect financial information and to perform a calculation to determine if the balance in the TRF (renamed the Individual Income Tax Elimination Fund (IITEF) in Division XX) is large enough to reduce the individual income tax rate as provided in the Bill.

To determine the new potential individual income tax rate, the DOR is directed to subtract the amount of the balance in the IITEF at the conclusion of the just-ended fiscal year (FY 2029 for the first calculation year) from the amount of net individual income tax the State received in that same fiscal year. Using this calculated result, the DOR is then directed to determine what individual income tax rate would have generated the calculated result in the just-ended fiscal year. If the calculation results in a rate that is at least 0.1 percentage point or more below the existing individual income tax rate, that calculated rate, rounded down to the nearest 0.1 percentage point, becomes the new individual income tax rate starting with the following tax year (TY 2030 for the first calculation year). The IITEF balance amount that was used in the new tax rate calculation is then transferred to the State General Fund in the fiscal year that the individual income tax rate is reduced. This process is repeated after each fiscal year in which the balance in the IITEF is greater than zero and the process continues until the individual income tax rate is reduced to zero.

Assumptions/Fiscal Impact (Division IX)

The TRF has an FY 2023 estimated balance of $1.961 billion and there are no appropriations or transfers scheduled from the Fund either under current law or under the Bill. This means that under existing law, the rate calculation at the end of FY 2029 will result in a substantial reduction in the individual income tax rate starting with TY 2030. That calculation, assuming no additional law changes, can be estimated as follows:

- Individual income tax revenue deposited to the General Fund, net of refunds issued, totaled $4.435 billion for FY 2021. Assuming no existing or future law changes and an annual growth rate of 3.50%, net individual income tax revenue for FY 2029 is estimated to total $5.840 billion as a base projection.
- Existing law changes are projected through previous fiscal notes to reduce individual income tax revenue by $479.6 million in FY 2029.
- The law changes contained in this Bill are projected to further reduce individual income tax revenue by $2.039 billion in FY 2029.
- Extrapolating from the first three assumptions, individual income tax revenue for FY 2029 is estimated to total $3.321 billion under existing law as amended in this Bill.
- The IITEF (the renamed TRF) is projected to have a balance of $1.961 billion in FY 2023. There are no current-law appropriations or transfers scheduled from that Fund and none are contained in this Bill. Adding projected interest earnings to be received by the IITEF through FY 2029, the balance in the Fund is estimated to be $2.061 billion at the end of that fiscal year.
- Subtracting the FY 2029 estimated balance in the IITEF ($2.061 billion) from the FY 2029 estimated individual income tax revenue ($3.321 billion), yields $1.260 billion, an amount that is 37.9% of projected FY 2029 individual income tax revenue.
- Under the Bill, the individual income tax rate is 3.60% for TY 2027 and after. The Bill directs a reduction in the individual income tax rate to a rate that would have produced $1.260 billion in FY 2029. The new rate is projected to be 1.30% (37.9% of 3.60%, rounded down to the nearest 0.1%).
- The Bill provides that the estimated $2.061 billion balance in the IITEF is transferred to the State General Fund during FY 2030.

Divisions XI and XII — Corporate Income Tax Rate Reduction

Description and Background

The Bill phases in reductions to Iowa's corporate income tax rates, beginning with TY 2024.

Current Iowa law provides for four corporate income tax brackets, with rates ranging from 5.5% to 9.8%. The phase in is effective for tax years beginning on or after January 1, 2024 and consists of the following rates and bracket numbers:

- TY 2024 — Three brackets with tax rates of 5.5%, 9.0%, and 9.4%.
- TY 2025 — Two brackets with tax rates of 5.5% and 9.0%.
- TY 2026 — Two brackets with tax rates of 5.4% and 8.6%.
- TY 2027 — Two brackets with tax rates of 5.4% and 8.2%.
- TY 2028 and after — Two brackets with tax rates of 5.3% and 7.8%.

Assumptions/Fiscal Impact (Divisions XI and XII)

The Department uses an income tax model that is based on Iowa corporate income tax returns filed for tax years 1990 through 2019 for law change projections. Tax liability for each return is forecasted for future years using tax rates and economic growth projections for corporate income, adjustments, and tax credits. The growth factors used in the model are primarily based on data provided by Moody's Analytics. The model provides two projections for each return. One projection based on current law and one on the law as proposed in the Bill. The fiscal impact is the tax liability difference between the two estimates. Fiscal impacts are presented on a net basis (gross corporate receipts adjusted for corporate income tax refunds issued).

The corporate income tax rate changes in the Bill are projected to reduce net corporate income tax liability and State General Fund revenue by the following amounts:

- FY 2024 — $8.8 million
- FY 2025 — $42.7 million
- FY 2026 — $83.8 million
- FY 2027 — $125.8 million
- FY 2028 — $169.1 million
- FY 2029 — $204.3 million

For years beyond FY 2029, the projected tax liability and State General Fund revenue reductions are expected to increase at the rate of growth in Iowa net corporate income.

Division XIII — Bank Franchise Tax Rate Reduction

Description and Background

The Bill reduces Iowa's current bank franchise tax rate of 5.0% of net income over five tax years. The tax rate is first reduced to 4.8% for TY 2023 and is reduced from there in 0.2 percentage point increments each tax year until the rate reaches 4.0% for TY 2027 and after.

The Iowa franchise tax applies to the net income of financial institutions that is apportioned to Iowa. The term "financial institution" refers to banks but also includes several other corporate structures. The term does not include credit unions.

The fiscal impact for a change in the franchise tax consists of two parts:
- Calculating the reduction in the franchise tax.
- Calculating the reduction in the use of the individual income tax Franchise Tax Credit that is the result of a decrease in the franchise tax rate. The Franchise Tax Credit is a mechanism to avoid the double taxation of financial institution profits. Double taxation would occur if the profits of an institution were taxed first at the entity (corporate) level and the owners were then taxed on the profits that flow to the owners and are included as income on their Iowa individual income tax return. The Franchise Tax Credit adjusts an owner's income for the fact that franchise tax was paid on the profits at the entity level. The Franchise Tax Credit is a nonrefundable credit.

Assumptions/Fiscal Impact (Division XIII)

The Department uses a bank profit projection process for the franchise tax that:
- Begins with a projection of net income at the entity (national) level using data from returns filed for tax years 2018 through 2020.
- Apportions each entity's net income to Iowa.
- Applies the current 5.0% tax rate and the proposed tax rate reductions.
- Subtracts tax credits.
- Compares the results using the current tax rate to the results using the proposed tax rate. This process determined that the revenue reduction at each step of the phased in rate reduction is estimated to be:
  - TY 2023 = 4.5%
  - TY 2024 = 9.0%
  - TY 2025 = 13.5%
  - TY 2026 = 18.0%
  - TY 2027 and after = 22.6%
- The projected reduction percentages were then applied to current law projections for gross franchise tax collections based on the most recent Revenue Estimating Conference projections for FY 2023 and Department projections for future years.

Based on 2007 through 2021 historical averages of franchise tax payments and Franchise Tax Credits, the Department estimates that for each $1.00 of reduced franchise tax, the corresponding reduction in Franchise Tax usage on Iowa individual income tax returns will increase individual income tax by $0.35.

The tax rate reductions in Division XIII are projected to reduce bank franchise tax liability and decrease the use of the Franchise Tax Credit. The amounts of the net tax liability and State General Fund revenue reductions are projected as follows:

- FY 2023 — $0.7 million
- FY 2024 — $2.7 million
- FY 2025 — $4.6 million
- FY 2026 — $6.9 million
- FY 2027 — $8.8 million
- FY 2028 — $10.1 million

For years beyond FY 2028, the projected tax liability and State General Fund revenue reductions are expected to increase at the rate of growth in Iowa bank net income.

Division XIV — Insurance Premium Tax Rate Reduction

Description and Background

The Bill reduces Iowa's current insurance premium tax rate of 1.00% of gross premiums in two increments. The rate is lowered to 0.95% for premiums collected in calendar year (CY) 2023 and to 0.90% for premiums collected in CY 2024 and after.

Under existing law, insurance companies that are not domiciled in Iowa may be subject to a higher tax rate if the insurance premium tax of their state of domicile is higher than the Iowa rate.

Assumptions/Fiscal Impact (Division XIV)

The Department used insurance premium tax returns filed for tax years 2018 through 2020 as the model for the proposed rate reduction, by computing each company's tax liability under existing law to their liability under the lower tax rates proposed in the Bill. The Department determined that the rate reductions would decrease tax liability by 5.4% for CY 2023 and 10.6% for CY 2024 and after. The projected reduction percentages were then applied to current law projections for gross insurance premium tax collections based on the most recent Revenue Estimating Conference projections for FY 2023 and Department projections for future years.

The tax rate reductions in Division XIV are projected to reduce insurance premium tax liability and State General Fund revenue by the following amounts:

- FY 2023 — $4.7 million
- FY 2024 — $13.0 million
- FY 2025 — $17.0 million
- FY 2026 — $17.3 million
- FY 2027 — $17.7 million
- FY 2028 — $18.0 million

For years beyond FY 2028, the projected tax liability and State General Fund revenue reductions are expected to increase at the rate of Iowa insurance premium growth.

Division XV — Automobile Rental Excise Tax Rate Increase

Description and Background

The Bill removes an exemption for platform car rentals where the registered owner of an automobile makes the automobile available for sharing through a peer-to-peer automobile sharing marketplace. The Bill increases the automobile rental excise tax rate 2.0 percentage points to 7.0%. The increased tax rate is effective January 1, 2023.

Currently, there is an excise tax imposed on the rental of passenger vehicles designed to carry nine or fewer passengers that are rented for a period of 60 days or less. This tax is in addition to the State sales tax and the LOST. The tax collected is distributed to the Road Use Tax Fund.

Assumptions/Fiscal Impact (Division XV)

The increase associated with the automobile rental excise tax rate will increase revenue to the Road Use Tax Fund by the following amounts:

- FY 2023 — $1.2 million (for one-half of the fiscal year)
- FY 2024 — $2.4 million
- FY 2025 — $2.5 million
- FY 2026 — $2.6 million
- FY 2027 — $2.7 million
- FY 2028 — $2.7 million

Division XVI — Equipment Tax Increase

Description and Background

The Bill increases the equipment tax rate 1.0 percentage point to 6.0%. The increased tax rate is effective January 1, 2023.

Currently, a tax of 5.0% is imposed on the sales price or purchase price of all equipment sold or used in the State subject to exemptions detailed in Iowa Code section 423D.3.

Assumptions/Fiscal Impact (Division XVI)

The tax rate increase associated with the equipment tax rate will increase State General Fund Revenue by the following amounts:

- FY 2023 — $1.1 million (for one-half of the fiscal year)
- FY 2024 — $2.3 million
- FY 2025 — $2.4 million
- FY 2026 — $2.5 million
- FY 2027 — $2.5 million
- FY 2028 — $2.6 million

Division XVII — Water Service Tax

Description and Background

The Bill repeals the water service tax and makes water sales subject to sales tax. This change is effective January 1, 2023. Iowa Code section 423G.7 provides for the future repeal of the water service tax upon an increase in the sales tax rate. The Bill increases the sales tax rate to 7.0%, which will trigger the automatic repeal of the water service tax. For FY 2021, the State collected $32.3 million in revenue from the water service tax.

Assumptions/Fiscal Impact (Division XVII)

The fiscal impact of this Division is reflected in **Table 1** and detailed in the increase of sales/use tax collected on water sales.

Division XVIII — Tax Credit Changes

Description and Background

Department analysis concludes that the Bill's changes to the following tax credits have no identifiable fiscal impact:

- **High Quality Jobs Tax Credit** — Requires the Economic Development Authority to prioritize the Research Activities Tax Credit.
- **Redevelopment Tax Credit** — Reduces refundability of the credit, currently 100.0%, to 75.0% starting TY 2023 and to 50.0% starting TY 2024.
- **Endow Iowa Tax Credit** — Limits the maximum tax credit dollar amount a single taxpayer may receive in a year.
- **Renewable Chemical Production Tax Credit** — Reduces the percent of tax credit awards that may be claimed as a refundable tax credit. The ability to carry forward unused tax credits remains.
- **Geothermal Heat Pump Tax Credit** — Prohibits the issuance of new awards after December 31, 2022.

Division XVIII requests that the Legislative Council authorize a study committee to meet during the 2029 Legislative Interim. If the Council approves the study committee, the committee is directed to review tax credits, with the review to specifically include the Adoption Tax Credit, Tuition and Textbook Tax Credit, and School Tuition Organization Tax Credit.

Assumptions/Fiscal Impact (Division XVIII)

The Bill's changes to the S Corporation Apportionment Tax Credit, Research Activities Tax Credit, and Charitable Conservation Contribution Tax Credit are projected by the Department to have fiscal impacts.

S Corporation Apportionment Tax Credit — The Bill eliminates the S Corporation Apportionment Tax Credit effective January 1, 2023. This tax credit allows Iowa shareholders in an S Corporation to limit their Iowa income tax liability to only the share of income the S corporation receives through the Iowa portion of the corporation's business. This allows the S corporation to be taxed more like a C corporation for Iowa income tax purposes. The tax credits are not transferrable or refundable and any unused credit does not carry forward to a subsequent tax year.

Under the Bill, the existing Out-of-State Tax Credit would remain. This credit allows a taxpayer to deduct income taxes paid to another state on income that is also taxed by Iowa.

The elimination of the S Corporation Apportionment Tax Credit is expected to increase the tax liability of Iowans who are shareholders in S corporations that do some portion of their business outside of Iowa. The Department utilized the following assumptions in estimating the fiscal impact of this provision:

- For TY 2020, 2,160 Iowa households claimed a total of $70.6 million in S Corporation Apportionment Tax Credits.

- Since the ability to utilize the existing Out-of-State Tax Credit remains, the Department assumed that a portion of the affected taxpayers will be able to utilize that credit instead. The Department's assumptions are as follows:
  - Twenty percent of current S corporation claims will utilize the Out-of-State Tax Credit at 100.0% of the current benefit to the taxpayer.
  - Fifty percent of current S corporation claims will utilize the Out-of-State Tax Credit at an averaged reduced benefit rate to the taxpayer of 70.0%.
  - Thirty percent of current S corporation claims will not be able to utilize the Out-of-State Credit as a replacement for the S Corporation Apportionment Tax Credit.
- Based on the previous assumption involving the switch to the Out-of-State Tax Credit, the Department utilized their individual income tax micromodel to develop this estimate. For an explanation of the micromodel and the Department's estimating process, please see the descriptions under Divisions VIII, IX, and X.
- The Department estimates that the elimination of the S Corporation Apportionment Tax Credit will increase tax liability and State General Fund revenue by the following amounts:
  - FY 2023 = $0.5 million
  - FY 2024 = $28.7 million
  - FY 2025 = $26.2 million
  - FY 2026 = $27.3 million
  - FY 2027 = $31.5 million
  - FY 2028 = $32.1 million

Fiscal impacts beyond FY 2028 are projected to continue, increasing each year at the rate of inflation. The Department's fiscal impact projection assumes the tax rates and retirement income exemption changes also included in this Bill. This means that if the S Corporation Apportionment Tax Credit provisions were estimated separately from the Bill's other provisions, the fiscal impact would be higher.

Research Activities Tax Credit — The Bill makes the following changes to the Research Activities Credit:

- Requires the use of the alternative simplified method of credit calculation for State purposes if that method was used by the applicant for the federal tax credit.
- Reduces the tax credit rate under the regular method of calculation from the current 6.50% to 4.0%.
- Reduces the tax credit rate under the alternative simplified method of calculation from the current rates of 4.55%/1.95% to 2.8%/1.2%.
- Disallows supplies and computer use expenses from being claimed as qualifying expenses as part of the credit calculation.
- Reduces tax credit refundability from the current 100.0% to 75.0% for TY 2023 and to 50.0% for TY 2024 and after.

The modifications of the Research Activities Tax Credit are expected to increase Iowa individual and corporate tax liability and increase State General Fund revenue. The Department utilized the following assumptions in estimating the fiscal impact of these provisions:

- Based on claims over the past three years, it is assumed that 75.0% of claims are from corporations and 25.0% are from individuals.
- Based on records for 2010 through 2019, it is assumed that 58.0% of credit claims will utilize the alternative simplified method and 42.0% will utilize the regular method.
- It is assumed that the disqualification of supplies and computer use expenses will decrease claims by 25.0%.
- It is assumed that tax credits that are not allowed for one tax year due to the reduced refundability provisions will not be allowed as carry forward claims the next tax year.

- The Department estimates that the changes to the Research Activities Tax Credit will increase individual and corporate income tax liability and State General Fund revenue by the following amounts:
  - FY 2024 = $28.9 million
  - FY 2025 = $50.1 million
  - FY 2026 = $55.3 million
  - FY 2027 = $58.5 million
  - FY 2028 = $61.7 million

Fiscal impacts beyond FY 2028 are projected to continue, increasing each year at the rate of inflation.

Charitable Conservation Contribution Tax Credit — The Bill eliminates the Charitable Conservation Contribution Tax Credit for contributions made on or after January 1, 2023.

- Tax credit claims for the 11-year period of 2008 through 2018 totaled $11.9 million, an annual average claim amount of $1.1 million.
- As this tax credit is not transferrable or refundable but may be carried forward, claims filed in one year take a number of years to reach full redemption. For this estimate, 80.0% of claims are assumed to be redeemed over six tax years and 20.0% of claims are assumed to expire without redemption.
- The LSA estimates that the elimination of the Charitable Conservation Contribution Tax Credit will increase individual income tax liability and State General Fund revenue by the following amounts:
  - FY 2024 = $0.3 million
  - FY 2025 = $0.7 million
  - FY 2026 = $0.8 million
  - FY 2027 = $0.8 million
  - FY 2028 and after = $0.9 million

Division XIX — Legislative Tax Expenditure Committee Changes

Description and Background

This Division repeals the Legislative Tax Expenditure Committee of the Legislative Council. The duty to submit tax expenditure reports to the Council is transferred from the Committee to the various departments that are responsible for oversite of the tax expenditures. The change is effective July 1, 2022, and is not projected to have an identifiable fiscal impact.

Division XX — Taxpayer Relief Fund Name Change to Individual Income Tax Elimination Fund

Description and Background

This Division changes the name of the existing Taxpayer Relief Fund (TRF) to the Individual Income Tax Elimination Fund (IITEF). The purpose and operation of the IITEF is addressed in Division IX of the Bill and is discussed in that portion of this ***Fiscal Note***.

Division XXI — National Guard Pay Income Tax Exemption

Description and Background

This Division expands an existing exemption for pay received by members of the National Guard for military service performed while on active duty to include pay for full-time service

performed pursuant to 32 U.S.C. Sections 502(f), 709(a), and 709(b). This change will exempt drill pay and the pay received by technicians while on active duty with the National Guard. The change is effective beginning TY 2023.

Assumptions/Fiscal Impact (Division XXI)

Utilizing 2021 data obtained from the Iowa National Guard covering rank, pay rates, and time in service, the Department estimates that $132.0 million in 2021 additional annual taxable income would have been exempt under the exemption provided in this Bill. The $132.0 million is adjusted for years beyond TY 2021 using the Employment Cost Index (ECI) for annual changes in military pay schedules. Projections of the ECI for each year through 2028 were obtained from the consensus scenario forecasts of Moody's Analytics.

The Department projects that the expanded income tax exemption for National Guard pay will reduce tax liability and General Fund revenue by the following amounts:

- FY 2024 = $7.1 million
- FY 2025 = $7.2 million
- FY 2026 = $6.5 million
- FY 2027 = $5.3 million
- FY 2028 = $5.1 million

Fiscal impacts beyond FY 2028 are projected to continue, increasing each year at the rate of increase in the ECI. The Department's fiscal impact projection assumes the tax rates and retirement income exemption changes also included in this Bill. This means that if the National Guard pay exemption provision was estimated separately from the Bill's other provisions, the fiscal impact would be higher.

Division XXII — Local Option Taxes

Description and Background

The Bill eliminates the LOST but specifies that 1.0% of the sales/use tax collected will be deposited into the Local Sales and Use Tax Fund to be distributed to the county from which the tax was collected. Required use of the funds deposited to each county is detailed in the Bill. These changes are effective January 1, 2023.

Currently, individual jurisdictions within counties may impose the LOST, allowing local governments to collect an additional 1.0% of tax in addition to the State sales tax. There are 55 jurisdictions without the LOST and 28 counties that have areas without the LOST. Revenue received from LOST for each county's account is distributed only to the individual jurisdictions that impose LOST, based on the population (75.0%) and property tax levies (25.0%). The population factor is based on the most recent certified federal census. The property tax factor is the sum of property tax dollars levied by boards of supervisors or city councils for the three years from July 1, 1982, through June 30, 1985. Only population and property tax levies of the individual jurisdictions imposing the tax are used in figuring the percentages.

Assumptions/Fiscal Impact (Division XXII)

Some individual jurisdictions will see revenue increases, while others will see revenue decreases. The Department estimates, as provided by the Iowa League of Cities, for the fiscal impact on all jurisdictions related to the LOST distributions can be found here.

The net fiscal impact to counties due to the elimination of the LOST and the increase in sales/use tax collections transferred to the Local Sales and Use Tax Fund is shown in **Table 3**.

Division XXIII — Natural Resources and Outdoor Recreation Trust Fund

Description and Background

The Bill modifies the Natural Resources and Outdoor Recreation Trust Fund by changing how the available revenue is distributed between the various accounts of the Trust Fund and by changing the purposes of the seven accounts. With the increase in the sales tax rate contained in Division I of the Bill, the Trust Fund will begin to receive revenue with calendar year 2023 (the second half of FY 2023). The increase in the sales tax rate also ends the annual $15.0 million allocation of State wagering tax receipts to the Water Quality Infrastructure Fund. Under existing law, the appropriation ends effective on July 1 after the increase in the sales tax.

Constitutional Amendment — On November 2, 2010, Iowa voters approved an amendment[1] to the Iowa Constitution that provides for the establishment of a Natural Resources and Outdoor Recreation Trust Fund (Trust Fund). Per the amendment, no revenue is to be credited to the Trust Fund until the sales tax rate is raised above the level established at the time of the adoption of the amendment. The Bill increases the State sales tax rate to 7.0%, which will trigger the funding of the Trust Fund. The Trust Fund receives revenue attributed to a three-eighths of 1.0% increase in the sales tax rate.

Natural Resources and Outdoor Recreation Trust Fund — The Trust Fund is created in Iowa Code chapter 461 for the purpose of implementing Article VII, section 10, of the Constitution of Iowa. The Trust Fund was enacted in 2010 Iowa Acts, chapter 1158 (SF 2310 — Natural Resources and Outdoor Recreation Trust Fund Act). The Trust Fund primarily receives sales tax revenue, as provided in the Constitution, but may also receive any additional funding as provided by law. Revenue in the Trust Fund is partitioned to seven separate accounts through specified percentages of the revenue stream. The seven account partitions sum to 100.0% of the available revenue. The Trust Fund retains interest earnings, and any unencumbered balance at the end of a fiscal year does not revert to any other fund.

The seven accounts of the Trust Fund under current law are as follows:

Natural Resources Account (23.0% of Trust Fund revenue) is administered by the Department of Natural Resources (DNR). The Account is to be used to establish, enhance, and restore parks, wildlife, water trails, rivers, streams, and other outdoor recreation property and for natural history and outdoor recreation education. Technical assistance and financial incentives to private landowners are also required.

Soil Conservation and Water Protection Account (20.0% of Trust Fund revenue) is administered by the Department of Agriculture and Land Stewardship (DALS). The Account is to be used to enhance soil conservation and watershed protection. The purposes of the Account may be accomplished through financial incentives and technical assistance. Support for the DALS Division of Soil Conservation and Water Quality and the Soil and Water Conservation District Commissioners is also required.

Watershed Protection Account (14.0% of Trust Fund revenue) is administered cooperatively by the DNR and DALS. The Account is to be used to protect, restore, or enhance surface water, watersheds, and water quality through financial assistance to communities and landowners. Watershed planning and watershed assessment are included as purposes of the Account.

[1] The text of the amendment is included at the end of this ***Fiscal Note.***

Iowa Resources Enhancement and Protection (REAP) Fund (13.0% of Trust Fund revenue) provides funding for continuation of the REAP Program (Iowa Code section 455A.18).

Local Conservation Partnership Account (13.0% of Trust Fund revenue) is administered by the DNR. Account revenue is to be distributed to local communities to maintain and improve parks, wildlife, water trails, rivers, streams, and other outdoor recreation property and for natural history and outdoor recreation education. Account revenue may also be used for the purposes described in Iowa Code section 350.1 (County Conservation Boards).

Trails Account (10.0% of Trust Fund revenue) is administered by the Department of Transportation and the DNR. Account revenue is to be used for the design, establishment, maintenance, improvement, and expansion of land trails. The DNR may also use Account revenue for water trails.

Lake Restoration Account (7.0% of Trust Fund revenue) is administered by the DNR. The Account is to be used for public lake restoration initiatives that improve water quality.

Assumptions/Fiscal Impact (Division XXIII)

Increasing the sales tax rate on January 1, 2023, will trigger the funding requirements of the Trust Fund as required by the Iowa Constitution. Under current law, the Trust Fund has no annual revenue. The increase in the sales tax rate will generate revenue for the Trust Fund beginning January 1, 2023. The projected revenue level for FY 2023 is $92.9 million and $191.4 million for FY 2024. In addition to providing funding for the Trust Fund, the Bill changes the allocation percentages to the various accounts of the Trust Fund and also modifies the name of the accounts. **Table 4** in the Fiscal Impact portion at the end of this ***Fiscal Note*** provides a five-year revenue and allocation projection for the Trust Fund. The top portion of **Table 4** provides the allocation under the existing percentages, and the middle portion provides the allocations under the Bill. The bottom portion provides a difference calculation, with positive numbers reflecting additional funding above what would occur if the sales tax rate increase occurred under existing law. Note that for this analysis the allocation projections are based only on sales tax revenue and do not include any interest or other revenue the Trust Fund might receive.

The following describes the Bill's major changes to the Trust Fund and its various accounts.

Natural Resources and Outdoor Recreation Trust Fund

- The Bill establishes Legislative Natural Resources and Outdoor Recreation Trust Fund Review Committee as a committee of the Legislative Council. The Committee is required to meet in calendar years 2030, 2040, and 2050. The Committee is to review the operation and management of the Fund and its various accounts and report the Committee's considerations and recommendations to the Council.
- Adds definitions for the terms:
  - Iowa Nutrient Reduction Strategy
  - Nonpoint source
  - Point source
  - Public use area
  - Water trail
- Alters the definition of the term "recreational purpose" by:
  - Restricting the definition to only the items listed in the definition. Under current law, the definition "includes" the items listed.

    - Adding biking, recreational shooting, archery, and using land or water trails to the list of activities included in the definition.
    - Deleting the term “other summer and winter sports” from the definition.
- Directs the Department of Revenue to annually project the amount of total revenue to be transferred to the Trust Fund during the following fiscal year and report the amount to the relevant State agencies and the LSA.
- Allows the use of up to 5.0% of the financial resources of the Trust Fund revenue allocated to an Account for administration.
- Assigns administration of the Trust Fund to the Department of Management and makes that Department responsible for the annual report to the Governor and General Assembly. The Bill requires that the annual report include an evaluation of how the Trust Fund has been used to achieve the goals of the Iowa Nutrient Reduction Strategy.
- Requires departments to prioritize expenditures that further the goals of the Iowa Nutrient Reduction Strategy and allows expenditures on projects having primarily a recreational purpose only in cooperation with the Economic Development Authority.
- Requires funding decisions for initiatives supporting public use areas to prioritize the improvement of existing public use areas.
- Requires sponsors of public trail initiatives to demonstrate how the trail is to be maintained by other sources of revenue.
- Prohibits the use of the Trust Fund to fund projects that establish, improve, or expand a baseball or softball diamond, tennis court, golf course, swimming pool, or other group or organized sport facility.
- Prohibits the use of the Trust Fund to support projects that require the exercising of the power of eminent domain.
- Allows departments to transfer funds between the various accounts of the Trust Fund in specified circumstances.
- Changes are effective January 1, 2023, and Iowa Code chapter 461 establishing the Trust Fund is repealed December 31, 2051.

Natural Resources Account

The Bill does the following:

- Changes the name to the Natural Resources Trust Account.
- Reduces the percentage of Trust Fund revenue that is dedicated to this Account from 23.0% to 18.0%.
- Prioritizes initiatives supporting maintenance, preservation, or restoration of land over initiatives that support the purchase or acquisition of land.
- Requires that the DNR develop an assessment mechanism to be used in the approval process for any Account expenditure that requires the purchase of land and requires that the DNR develop an index that justifies the removal of land from private ownership and use.
- Adds the construction or improvement of facilities located on land owned or managed by the Department to the allowed uses of the Account.
- Removes a requirement that the DNR is to consider its comprehensive plan (Iowa Code section 456A.31) when making Account funding decisions.

Soil Conservation and Water Protection Account

The Bill does the following:

- Changes the name to the Soil Conservation and Nonpoint Source Water Protection Trust Account.
- Increases the percentage of Trust Fund revenue that is dedicated to this Account from 20.0% to 34.0%.
- Allocates 47.0% of the financial resources of the Account to support:

    - The Water Quality Agriculture Infrastructure Programs created in Iowa Code section 466B.43. The Programs provide cost-share funding to agricultural landowners where infrastructure projects capture or filter nutrients, associated contaminants, and sediment.
    - The Water Quality Urban Infrastructure Program created in Iowa Code section 466B.44. The purpose of the Program is to support watershed projects and advance implementation of the Iowa Nutrient Reduction Strategy. Program support may include demonstration projects that decrease erosion, precipitation-induced surface runoff, and storm water discharges and that increase water infiltration rates. The Program provides financial assistance on a cost-share basis or through cooperative agreements with watershed projects located in rural areas and funded through Iowa Code section 455B.199 (Water Resource Restoration Sponsor Program). The DALS may use up to 4.0% of the funds distributed to the Water Quality Urban Infrastructure Program for administration.
- Allocates the remainder (53.0%) of the financial resources of the Account to support the following initiatives:
    - Soil conservation and watershed protection.
    - The conservation of highly erodible land.
    - Soil conservation or crop management practices used on land producing biomass for biorefineries.
- Permits unencumbered or unobligated funds from the 53.0% Account allocation to be transferred to support the purposes of the 47.0% Account allocation.

Watershed Protection Account

The Bill does the following:

- Changes the name to the Water Protection Trust Account.
- Increases the percentage of Trust Fund revenue that is dedicated to this Account from 14.0% to 15.0%.
- Directs 47.0% of the Account financial resources to the Water Quality Financial Assistance Fund (Iowa Code section 16.134A). The Water Quality Financial Assistance Fund is allocated by percentage as follows:
    - Forty percent to the Wastewater and Drinking Water Treatment Financial Assistance Program (Iowa Code section 16.134). Financial assistance under this Program is to be used to install or upgrade wastewater treatment facilities and systems and drinking water treatment facilities and systems, including source water protection projects, and for engineering or technical assistance for facility planning and design. The Iowa Finance Authority may use up to 1.0% of the funds distributed to the Program for administration.
    - Forty-five percent to the Water Quality Financing Program Fund (Iowa Code section 16.153). The Fund is administered by the Iowa Finance Authority as a revolving fund. The Fund provides financial assistance, including loans, forgivable loans, and grants, to eligible entities. The Fund is to be administered in such a manner as to provide a permanent source of water quality project financial assistance to eligible entities. The Authority may use up to 1.0% of the funds distributed to the fund for administration.
    - Fifteen percent to the Water Quality Urban Infrastructure Program (Iowa Code section 466B.44) (see Program description above).
- Directs 26.5% of the Account financial resources to support DNR water quality resource projects as follows:
    - Water quality resource projects through the provision of financial assistance to communities for watersheds, including the Water Resource Restoration Sponsor Program (Iowa Code section 455B.199). This Program is described earlier in the description of this Account.

    - Regional and community watershed assessment, planning, and prioritization efforts, including as provided in Iowa Code chapter 466B (Surface Water Protection, Flood Mitigation, and Watershed Management).
    - Water quality protection programs provided in Iowa Code section 466.7 that relate to the administration of watershed geographic information systems, water quality monitoring, floodplain permitting, and flood protection education.
- Directs 26.5% of the Account financial resources to the DALS for water protection projects and practices as described in the Iowa Nutrient Reduction Strategy, including support to the Conservation Buffer Strip Program (Iowa Code section 466.4) and the Conservation Reserve Enhancement Program (Iowa Code section 466.5).
- Permits unencumbered or unobligated funds from the two 26.5% Account allocations to be transferred to the Water Quality Financial Assistance Fund (Iowa Code section 16.134A). The use of this Fund is described earlier under this heading.

Iowa Resources Enhancement and Protection (REAP) Fund Allocation

The Bill does the following:

- Decreases the percentage of Trust Fund revenue that is dedicated to the REAP Fund (Iowa Code section 455A.18) from 13.0% to 10.0%. The allocation of moneys within the REAP Fund is provided in Iowa Code section 455A.19. The first $350,000 is allocated annually to the Conservation Education Program Board for the purposes specified in Iowa Code section 455A.21. One percent of REAP funds may be used for administration. The remaining funds are allocated to the following REAP purposes:
    - 28.0% to the Open Spaces Account.
    - 20.0% to the County Conservation Account.
    - 20.0% to the Soil and Water Enhancement Account.
    - 15.0% to the Parks and Open Spaces Account for cities.
    - 9.0% to the State Land Management Account.
    - 5.0% to the Historical Resource Grant and Loan Fund (Iowa Code section 303.16).
    - 3.0% to the Living Roadway Trust Fund (Iowa Code section 314.21).
- Repeals the annual $20.0 million General Fund appropriation to REAP effective January 1, 2023. This standing appropriation is scheduled to end after FY 2026 under current law.
- Repeals the Iowa Congress on Resources Enhancement and Protection and replaces it with regional meetings to be held every four years, with the first meeting to be held in 2023. Meeting expenses are to be paid from the DNR Administration Fund.
- Repeals the County Resource Enhancement Committee effective January 1, 2023.

Local Conservation Partnership Account

The Bill does the following:

- Changes the name to the Local Conservation Partnership Trust Account.
- Decreases the percentage of Trust Fund revenue that is dedicated to this Account from 13.0% to 9.0%.
- Adds a watershed management authority as an entity that is eligible to participate in projects financed through the Account.
- Adds the maintenance and improvement of forests as an eligible Account project.
- Removes water trails as an eligible Account project.
- Requires a minimum local cost-share match for projects financed through the Account. The minimum cost-share requirements are:[2]

[2] Based on the results of the 2020 U.S. Census, Iowa has 48 counties with a population of 15,000 or less and six counties with a population greater than 100,000.

- Ten percent for communities located in a county with a population of 15,000 or less.
- Twenty-five percent for communities located in a county with a population between 15,001 and 100,000.
- Seventy-five percent for communities located in a county with a population of 100,000 or more.

Trails Account

The Bill does the following:

- Changes the name to the Water and Land Trails Trust Account.
- Decreases the percentage of Fund revenue that is dedicated to this Account from 10.0% to 4.0%.
- Requires the allocation of 50.0% of the Account financial resources to land trails and 50.0% to water trails. Under current law, the Account is required to be used for land trails and may be used for water trails.
- Requires stream restoration to be a priority of the water trails portion of the Account.
- Allows the transfer of unencumbered or unobligated funds between the land trails and water trails purposes of the Account.
- Allows the transfer of unencumbered or unobligated water trails funds to other Trust Fund accounts.

Lake Restoration Account

The Bill does the following:

- Changes the name to the Lake and Stream Restoration Trust Account.
- Increases the percentage of Trust Fund revenue that is dedicated to this Account from 7.0% to 10.0%.
- Adds the stabilization and restoration of stream banks as an eligible Account project.
- Adds the furtherance of the goals of the Iowa Nutrient Reduction Strategy as a project prioritization factor for the Account.

The Bill amends existing Trust Fund provisions to allow the relevant departments to expend up to 5.0% of Trust Fund allocations for administrative purposes. If fully utilized, the administrative expenditure would total approximately $10.0 million per full fiscal year. In addition to the overall administration expense provision, several of the programs funded by the Trust Fund have within them administrative expenditure permissions and limits.

Division XXIV — Code Editor Directive

Description and Background

This Division directs the Iowa Code Editor to harmonize Iowa Code provisions amended in two or more operations of the Bill and to make other related changes if necessary. The directive is effective July 1, 2022, and is not projected to have an identifiable fiscal impact.

Fiscal Impact

State General Fund — The Bill has numerous provisions that increase and decrease General Fund revenue. The Bill also has provisions that distribute General Fund revenue to accounts outside of the General Fund. **Table 3** summarizes the various tax and tax credit provisions that are projected to increase or decrease State General Fund receipts. The summed result of all provisions is a reduction in General Fund receipts of $260.4 million for FY 2023, increasing to $2.168 billion by FY 2028.

Table 3 — Projected General Fund Revenue Change by Provision and by Tax Type

In Millions

Division	Tax Provision	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
I	Sales/Use Tax Rate Increase	$ 315.0	$ 650.5	$ 668.0	$ 685.6	$ 705.9	$ 727.0
II	Sales Tax Base Expansion	59.9	122.0	125.4	127.6	126.8	125.2
XVI	Equipment Tax Rate Increase	1.1	2.3	2.4	2.5	2.5	2.6
IV	LOST Distribution	-313.6	-645.9	-663.1	-680.1	-699.2	-719.5
IV	SAVE Distribution Increase	-8.3	-16.9	-17.3	-17.6	-17.5	-17.3
XXIII	Natural Resource Fund Distribution	-92.9	-191.4	-196.4	-201.5	-207.1	-213.2
V	Stock Capital Gains Exemption	0.0	-4.0	-7.6	-10.3	-8.9	-8.8
VI	Farm Lease Income Exemption	0.0	-2.1	-2.0	-1.8	-1.5	-1.5
VII	Farm Capital Gains Exemption	0.0	-7.2	-6.9	-6.1	-5.1	-5.3
VIII, IX	Individual Income Tax Rate Reduction	-37.3	-135.7	-352.1	-969.5	-1,552.2	-1,692.9
X	Retirement Income Exemption	-179.6	-353.3	-340.6	-359.8	-363.9	-376.4
VIII, IX	Income Tax Rate and Retirement Interaction	0.2	7.0	25.9	83.4	108.4	119.7
XXI	National Guard Pay Exemption	0.0	-7.1	-7.2	-6.5	-5.3	-5.1
XI, XII	Corporate Income Tax Rate Reduction	0.0	-8.8	-42.7	-83.8	-125.8	-169.1
XIII	Franchise Tax Rate Reduction	-1.1	-4.1	-7.1	-10.5	-13.5	-15.5
XIII	Franchise Tax Credit	0.4	1.4	2.5	3.6	4.7	5.4
XIV	Insurance Premium Tax Rate Reduction	-4.7	-13.0	-17.0	-17.3	-17.7	-18.0
XVIII	S Corporation Apportionment Tax Credit	0.5	28.7	26.2	27.3	31.5	32.1
XVIII	Research Activities Credit, Corporate Income	0.0	21.7	37.6	41.5	43.9	46.3
XVIII	Research Activities Credit, Individual Income	0.0	7.2	12.5	13.8	14.6	15.4
XVIII	Charitable Conservation Contribution Tax Credit	0.0	0.3	0.7	0.8	0.8	0.9
	Total	$ -260.4	$ -548.4	$ -758.8	$ -1,378.7	$ -1,978.6	$ -2,168.0
	Change by Tax Type (Net)	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
	Individual Income Tax	$ -215.8	$ -464.8	$ -648.6	$ -1,225.1	$ -1,776.9	$ -1,916.5
	Sales/Use Tax	-38.8	-79.4	-81.0	-83.5	-88.6	-95.2
	Corporate Income Tax	0.0	12.9	-5.1	-42.3	-81.9	-122.8
	Franchise Tax	-1.1	-4.1	-7.1	-10.5	-13.5	-15.5
	Insurance Premium Tax	-4.7	-13.0	-17.0	-17.3	-17.7	-18.0
	Total	$ -260.4	$ -548.4	$ -758.8	$ -1,378.7	$ -1,978.6	$ -2,168.0

Several of the provisions are phased in over a number of tax years. However, with the exception of the corporate income tax rate reduction, all provisions are projected to be fully phased in by the conclusion of FY 2028.

Income Surtax for Schools — The income surtax for schools is a local option tax that is based on a taxpayer's Iowa individual income tax liability. Law changes that lower Iowa individual income tax liability also lower the amount of surtax owed by any taxpayer subject to the surtax. For this projection, the surtax is assumed to equal 2.6% of State individual income tax liability. The decrease in tax liability is projected to decrease the statewide yield of the local option income surtax for schools by $5.6 million in FY 2023, growing to $49.8 million by FY 2028. To adjust for the reduction in surtax revenue, local school districts that have the surtax in place may raise the surtax percentage in order to reduce the level of revenue reduction.

Natural Resources and Outdoor Recreation Trust Fund — The increase in the State sales tax rate to 7.0% triggers the funding requirement for the Trust Fund. **Table 4** displays the projected distribution of Trust Fund sales tax revenue to the various accounts under existing law and under the changes to the distribution formula contained in the Bill.

Table 4
Natural Resources and Outdoor Recreation Trust Fund Allocations
Under Current Law Allocations and Under the Bill
In Millions

Trust Fund Revenue from Sales Tax	$ 92.9	$ 191.4	$ 196.4	$ 201.5	$ 207.1

	Allocations Under Current Law				
Account Name (Current Law)	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
Natural Resources Account	$ 21.4	$ 44.0	$ 45.2	$ 46.3	$ 47.6
Soil Conservation and Water Protection Account	18.6	38.3	39.3	40.3	41.4
Watershed Protection Account	13.0	26.8	27.5	28.2	29.0
Iowa Resources Enhancement and Protection Fund	12.1	24.9	25.5	26.2	26.9
Local Conservation Partnership Account	12.1	24.9	25.5	26.2	26.9
Trails Account	9.3	19.1	19.6	20.2	20.7
Lake Restoration Account	6.5	13.4	13.7	14.1	14.5
Rounding Adjustment	-0.1	0.0	0.1	0.0	0.1
Total	$ 92.9	$ 191.4	$ 196.4	$ 201.5	$ 207.1

	Allocations Under Bill				
Account Name (Amended)	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
Natural Resources Trust Account	$ 16.7	$ 34.5	$ 35.4	$ 36.3	$ 37.3
Soil Conservation and Nonpoint Source Water Protection Trust Account	31.6	65.1	66.8	68.5	70.4
Watershed Protection Trust Account	13.9	28.7	29.5	30.2	31.1
Iowa Resources Enhancement and Protection Fund	9.3	19.1	19.6	20.2	20.7
Local Conservation Partnership Trust Account	8.4	17.2	17.7	18.1	18.6
Water and Land Trails Trust Account	3.7	7.7	7.9	8.1	8.3
Lake and Stream Restoration Trust Account	9.3	19.1	19.6	20.2	20.7
Rounding Adjustment	0.0	0.0	-0.1	-0.1	0.0
Total	$ 92.9	$ 191.4	$ 196.4	$ 201.5	$ 207.1

	Revenue Differences Due to Allocation Changes				
Account Name (Amended)	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
Natural Resources Trust Account	$ -4.7	$ -9.5	$ -9.8	$ -10.0	$ -10.3
Soil Conservation and Nonpoint Source Water Protection Trust Account	13.0	26.8	27.5	28.2	29.0
Watershed Protection Trust Account	0.9	1.9	2.0	2.0	2.1
Iowa Resources Enhancement and Protection Fund Allocation	-2.8	-5.8	-5.9	-6.0	-6.2
Local Conservation Partnership Trust Account	-3.7	-7.7	-7.8	-8.1	-8.3
Water and Land Trails Trust Account	-5.6	-11.4	-11.7	-12.1	-12.4
Lake and Stream Restoration Trust Account	2.8	5.7	5.9	6.1	6.2
Rounding Adjustment	0.1	0.0	-0.2	-0.1	-0.1
Total	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0

Other Issues and Recommendations

Individual Income Tax Rate for TY 2030 — Division IX puts in place a procedure designed to eliminate the State income tax over time. The procedure utilizes the balance in the Individual Income Tax Elimination Fund (currently named the Taxpayer Relief Fund) to reduce the income tax rate if, after FY 2029, the balance in the Fund is sufficient to trigger a rate reduction as provided in the Bill. The LSA projects that without future law changes that lower the balance in the Fund, the Iowa individual income tax rate will be reduced to 1.30% beginning tax year 2030. The size of this rate change would reduce annual General Fund revenue by over $2.000 billion starting in calendar year 2030. This decrease would be in addition to the projected revenue decreases outlined in **Table 3**.

Trust Fund Revenue Assumptions — The language in the Iowa Constitution that requires the distribution of tax revenue to the Trust Fund utilizes the phrase “an amount generated by a sales tax rate”. This ***Fiscal Note*** is based on the interpretation that the sales tax reference means that the revenue generated by the State sales tax alone, and not the sales and use tax, is to be used in calculating the annual amount that is generated by three-eighths of 1.0% of the tax. Since use tax represents 20.0% to 23.0% of total sales and use tax, this interpretation has a significant impact on the annual revenue projections for the Trust Fund. This interpretation

may ultimately not prove to be correct, as the language in the Constitution may also be interpreted to encompass use tax revenue, or alternatively, some or all of what is presently being deposited in the State General Fund as use tax may ultimately be determined to be actually sales tax revenue. The LSA recommends that the Bill specifically address what revenue is to be considered sales tax when calculating the revenue split between the General Fund and the Trust Fund.

State Cost of Administration — The new qualified stock, farm lease, and farm capital gains exemptions are expected to increase the administrative and enforcement costs experienced by the Department of Revenue. No estimate of the annual increase in costs is available at this time. Additionally, the creation of the Trust Fund will also increase the administrative expenses of the State agencies charged with implementing the new Trust Fund. The Trust Fund contains a provision that up to 5.0% of Trust Fund revenue may be used for administration.

Sources

Iowa Department of Revenue
Moody's Analytics
Iowa National Guard
Iowa League of Cities
LSA calculations
Article VII, Section 10, Iowa Constitution (text below)

Text of Constitutional Amendment

A natural resources and outdoor recreation trust fund is created within the treasury for the purposes of protecting and enhancing water quality and natural areas in this state including parks, trails, and fish and wildlife habitat, and conserving agricultural soils in this state. Moneys in the fund shall be exclusively appropriated by law for these purposes.

The general assembly shall provide by law for the implementation of this section, including by providing for the administration of the fund and at least annual audits of the fund.

Except as otherwise provided in this section, the fund shall be annually credited with an amount equal to the amount generated by a sales tax rate of three-eighths of one percent as may be imposed upon the retail sales price of tangible personal property and the furnishing of enumerated services sold in this state.

No revenue shall be credited to the fund until the tax rate for the sales tax imposed upon the retail sales price of tangible personal property and the furnishing of enumerated services sold in this state in effect on the effective date of this section is increased. After such an increased tax rate becomes effective, an amount equal to the amount generated by the increase in the tax rate shall be annually credited to the fund, not to exceed an amount equal to the amount generated by a tax rate of three-eighths of one percent imposed upon the retail sales price of tangible personal property and the furnishing of enumerated services sold in this state.

/s/ Holly M. Lyons

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The fiscal note for this Bill was prepared pursuant to Joint Rule 17 and the Iowa Code. Data used in developing this fiscal note is available from the Fiscal Services Division of the Legislative Services Agency upon request.

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